



# CASE STUDIES

# PRIVATE LENDING

*Midland IRA's role as the administrator of self-directed retirement accounts is non-discretionary and/or administrative in nature. The account holder or his/her authorized representative must direct all investment transactions and choose the account's investment(s). Midland IRA has no responsibility or involvement in selecting or evaluating any investment. Nothing contained herein shall be construed as investment, legal, tax, or financial advice or as a guarantee, endorsement, or certification of any investments.*



## **SECURED NOTE LENDING ALLOWS THE COVID PANDEMIC ROLLER COASTER RIDE TO BE A LITTLE SMOOTHER**

Syed from Illinois invests in real estate loans to property flippers.

***"Short-term loan investments are an excellent source of passive income. Through private lending from my Midland Self-Directed IRA, I am able to get a passive income of 12% to 16% ROI and use this as a major component of a diversified portfolio."***

-Syed

### **How It Works**

Once he finds a borrower to work with, Syed works with his attorney to prepare the note and mortgage documents where his IRA is listed as the lender. Having the IRA listed as the lender on the mortgage adds additional security to the investment as he may be able to foreclose on the property in the event the borrower defaults. Additionally, he can secure a lender's title policy as well as have the IRA added as an additional insured on a hazard insurance policy.

However, it is important not to let the insurances and mortgage add a false sense of security. Syed says, "It is extremely important for one to fully understand and learn investment strategies, do the due diligence, and have a clear idea of the risks involved."

Once all of the documents are prepared, Syed and the borrower have a formal closing with a title company. Funds are then sent from the IRA to the borrower for use on the

renovations of the property being flipped. Payments on the loan are made per the terms outlined in the note agreement. Once the improvements are complete, the property is put up for sale. Funds are then returned to the IRA once the property is sold.

### **Private Lending Through the Pandemic**

While Syed has always seen private lending as a great way to diversify his portfolio, he is particularly grateful for the diversification during the recent COVID-19 pandemic. "In today's COVID-19 financial crisis, I have been able to avoid selling my securities and, in fact, take more than my RMD as a form of income," explains Syed. "[Private Lending] has enabled me to get a higher ROI while avoiding fluctuations and uncertainty in the stock, ETF, and bond markets. In this regard, I have been able to enjoy a well-deserved retirement while not having to worry when the rest of the financial world will begin to recuperate from the COVID-19 crisis."

### **THE INVESTMENT**

#### **\$155,000 Mortgage (12% Interest)**

<b>Amount:</b>	\$151,870 <small>(2 Points Withheld)</small>
<b>Income Received:</b>	\$6,200
<b>Total Costs:</b>	\$1,038
<b>Payoff Amount:</b>	\$159,650
<b>Total Income Received:</b>	\$13,980
<b>Length of Note:</b>	7 Months
<b>Calculated Return:</b>	<b>14.6%*</b>

\*This figure was calculated by the IRA owner.

## FROM LANDLORD TO LENDER - UTILIZING OWNER-FINANCING IN A SELF-DIRECTED IRA

Renate, a real estate investor from North Carolina, was able to use owner-financing to turn her IRA held active real estate investment into a passive real estate investment.

### Becoming the Bank

In 2015, Renate had rolled over an old 401(k) into a self-directed traditional IRA with Midland. She used her retirement funds to invest in a single-family property, where her IRA was the deeded owner of the property. Renate promptly rented out the home after closing, receiving \$1,000 a month in rent to her Midland IRA.

When Renate found out her tenants were having trouble trying to buy a house, it was an opportunity for Renate to transition from landlord to lender. Renate was able to achieve this by selling the property with owner-financing. "They had always been great renters," says Renate. "When I heard they were having trouble getting a loan from the bank, I thought, this could be a good opportunity for my retirement and them."

At closing, Renate's IRA deeded the property over to the tenants and simultaneously recorded a deed of trust on the same property where the IRA was listed as the lender. Renate's IRA could foreclose on the borrowers and regain title to the property in the event of default.

### Transitioning From Active to Passive Real Estate Investing

When Renate initially purchased the property, her IRA would receive the monthly rental payments as income. If any expenses came up, such as property taxes or items requiring repair, Renate could request those expenses be paid through the IRA.

Instead of rental income, Renate now receives mortgage payments to her IRA. "It is also nice to no longer have the responsibilities of a landlord!" commented Renate. "I really like the new online option that my borrowers can use to make electronic payments."

"Midland has made the process really simple for me, and their service is fantastic." says Renate. "They are the best in the business!"

### THE INVESTMENT

<b>Property Purchase Amount:</b>	\$130,000
<b>Total Rental Income:</b>	\$30,000
<b>Total Expenses:</b>	\$12,482
<b>Sale Proceeds:</b>	\$7,860
<b>Owner-Financed Amount:</b>	\$161,000
<b>Mortgage Income:</b>	\$10,678
<b>Calculated Return:</b>	<b>35%*</b>

## **INVESTING IN A PRIVATE LLC AS A PARTNER IN A HOTEL**

Neville, from Fort Myers, Florida, used his self-directed IRA to purchase an interest in an LLC that built a national franchise hotel and operated it for nine years. The underlying asset was sold, netting Neville an excellent return.

### **Purchasing an LLC Interest**

Using a self-directed IRA can make investing in a private LLC easy. A private LLC can make many different investments. In our scenario, Neville purchased a 3% interest in this LLC for his \$158,000. His ownership interest guaranteed an 8% return annual from hotel operations (assuming they hit certain targets). He did get this return for nine years.

The second half of the deal was getting 75% of any gain on the hotel's sale. In 2019, the hotel sold for \$8 million after closing costs. Neville's 3% share was \$252,800. His gain portion was \$94,800 (\$252,800 less his cost of \$158,000). He was required to give 25% to the operator of the LLC.

After nine years, Neville's total return was over 13%. This return includes an annual income of \$12,640 from the hotel and a gain of \$71,100 from the hotel's sale.

As you can see, this was an excellent investment. The caveat here is that this was a self-directed investment that Neville chose and did due diligence on with his tax advisor.

LLC or private placements are among the most popular vehicles to invest large assets that require multiple investors. This deal was set up as an LLC, but it would not

be uncommon to see this type of investment as a private placement. If it was a private placement setup, it would be common for all investors to be considered accredited investors.

### **THE INVESTMENT**

<b>Investment Amount:</b>	\$158,000
<b>Total Costs:</b>	\$2,855
<b>Total Income Received:</b>	\$113,760
<b>Length of Investment:</b>	9 Years
<b>Net Gain of the Asset:</b>	\$71,100
<b>Annual Income Return:</b>	8%
<b>Calculated Total Annual Return:</b>	<b>13%</b>
<b>Total Asset Return:</b>	<b>45%</b>

## INSTITUTIONAL INVESTING WITH A SELF-DIRECTED IRA

Chicago, Illinois (2015), Dr. Chris decided to use his self-directed IRA to invest \$300,000 in an institutional fund specializing in purchasing dental offices throughout the United States. The underlying assets were aggregated and sold after four and a half years, producing a positive return for the IRA.

### Purchasing an LLC Interest

Dr. Chris is a vascular surgeon from River Forest, Illinois, a suburb of Chicago. Chris had been very successful in his IRA investing and was looking for an opportunity to diversify. He was introduced to this investment by his financial advisor. The institutional Fund, Ontario Dental Fund, raised approximately \$25 million dollars to purchase small to medium-sized dental practices. The Fund organizers have specialized in buying and selling these types of businesses. This Fund was registered with the SEC.

One of the differences with an institutional investment is that you must be an accredited investor. Typically, that means you have a net worth above \$1 Million dollars.\*

Another unique aspect of institutional investments is that they can require additional capital calls after purchasing the Fund. In this case, the capital calls would be in increments of 3% of the original investment.

Dr. Chris's investment in the Ontario Dental Fund had a life of 4 years. During this time, he had two capital calls of \$9,000, making his total investment \$318,000. Typically, capital calls are used to purchase more assets in the Fund.

The purpose of this Fund was to purchase small dental practices at a multiple of 5X EBITDA. Once the dental practice was acquired, it was re-branded in the Ontario name. The fund organizers believed that the sum would be worth more as a group once they acquired enough practices. In this case, it was. The life was of this Fund was advertised to be five to seven years. At year four, the Fund realized that their investment was now worth 8X EBITDA.

The Fund sold the underlying group at the end of year four for \$40,000,000 (after closing expenses). Dr. Chris owned approximately 1.2% of the Fund, and his net proceeds were \$480,000.

Institutional investments can be extremely complex. Please consult your tax or financial advisor before investing in a complex strategy like this example above. Midland IRA is an administrator and does not give investment advice.

\*Click [here](#) for the definition of an accredited investor.

### THE INVESTMENT

<b>Investment Amount:</b>	\$318,000
<b>Capital Calls:</b>	\$18,000 (2 x \$9,000)
<b>Total Costs:</b>	\$1,085
<b>Length of Investment:</b>	4.5 Years
Net Gain of the Asset:	\$71,100
<b>Net Proceeds:</b>	\$160,915
<b>Annual Income Return:</b>	<b>11.24%</b>
<b>Total Return:</b>	<b>50.6%</b>

## ANGEL INVESTING WITH A SELF-DIRECTED IRA

Rob H. from Chicago belongs to an angel investment club. He has the option to invest in club deals as an individual investor or by using his Midland self-directed account. Using his IRA allows him to pick and choose which investments are best suited for his current situation.

### Unique Opportunities With Angel Investing

Angel clubs allow members once-in-a-lifetime opportunities to invest in start-up companies. Everyone wants to find the next Shark Tank type company and make it big. Rob's club has quarterly meetings and offers its investors two opportunities to get into a deal. Option one: the club will form a special purpose LLC that will allow investors to pool their money into a new company. These funds invested into the "Club" LLC are usually between \$15,000 to \$50,000. Alternatively, you can invest in a new company directly with a much more considerable investment amount (\$100,000 or more).

Here are the two start-up investment opportunities in which Rob chose to invest using his self-directed account.

#### Start-Up #1

Rob Invested \$35,000 in a Tech business that specialized in API technology. Rob held this investment for three years. Another Tech company acquired the API company. The LLC received its share and was liquidated. Rob was returned \$50,000 in three years.

#### Start-Up #2

Rob invested in a sustainable clothing company that allowed its current clients to return clothing for a 20% credit on their

next purchase. The returned clothing was recycled. 2020 was the second year in this investment; the company was on track to break even that year. Rob invested \$40,000 in a club LLC. The exit strategy is planned for 2023.

Angel Investing can be complicated, but one of the benefits is that you have the opportunity to discuss and evaluate these investments with other like-minded investors. You also benefit from investing smaller amounts via club-established LLCs, where investments are pooled. Typically, when you invest in this pooled arrangement, you are required to be an accredited investor.\*

Rob is an experienced investor, and angel investing is just one of the vehicles he uses to build wealth. A Midland self-directed IRA is easy to set up, and our advanced technology translates to investments that are just a few clicks away.

\*Click [here](#) for the definition of an accredited investor.

### THE INVESTMENT

<b>Investment Amount:</b>	\$35,000
<b>Total Costs:</b>	\$1,075
<b>Total Income Received:</b>	\$50,000
<b>Length of Investment:</b>	3 Years
<b>Net Gain of the Asset:</b>	\$13,925
<b>Calculated Annual Return:</b>	<b>13.26%</b>
<b>Total Return:</b>	<b>39.78%</b>

# PRIVATE BANK STOCK

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## **SMALL INVESTMENT IN PRIVATE BANK STOCK OFFERS HUGE RETURN**

Charles, a retired school principal who currently lives in Southwest Florida, has had success with a small investment in private bank stock. By taking advantage of the opportunity to invest in the early stages of a growing bank, Charles was able to turn \$10,005 into \$31,900.

### **Taking Advantage of Local Growth**

In December of 2009 Charles used his Midland Self-Directed Traditional IRA to purchase shares of Sanibel Captiva Community Bank private stock for \$10,005. He chose to invest in Sanibel Captiva Community Bank stock because he and his wife Barbara lived on Sanibel Island for over ten years and knew so many reputable people involved with the bank, such as board members and employees. He has held this private stock in his self-directed IRA at Midland for 11 years and has never sold any shares or taken any in-kind distributions. He never imagined that this investment would be such a success and that the quarterly dividends alone would be enough to cover his yearly required minimum distribution. Furthermore, Charles has reaped the benefit of consistent stock price appreciation and now fast forward to 2020, the market value of his investment is \$31,900.

### **Diversifying With Private Stock**

Charles was fortunate enough to work for a Georgia school system that offered an excellent employer-sponsored retirement plan, but he recognized the importance of diversifying beyond the market even after retirement. He knew that he needed to make a smart investment that

would provide an income stream to cover every day expenses but also be in line with his risk tolerance.

Southwest Florida was experiencing a tremendous amount of growth at the time, so the Sanibel Captiva Community Bank stock was a pure play. Charles believes that this is one of the best investments that he has ever made and attributes a lot of the credit to his ability to self-direct it. By self-directing this investment, all of the dividends go right back into his Traditional IRA account tax deferred. And since Midland is not a fiduciary, Charles does not have to pay any commissions or advisor fees. Another great aspect of this investment is the fact that Midland safeguards his original stock certificates in a vault so Charles has always had peace of mind knowing the certificates are in good hands.

Charles has been a long time, happy Midland client. When asked if he would recommend self-direction to others, Charles stated the following, "Of course, just look at what the account has done for me, not to mention the customer service at Midland is world-class!"

### **THE INVESTMENT**

<b>Initial Price Per Share:</b>	\$13.80
<b>Shares Purchased:</b>	725
<b>Initial Investment Total:</b>	\$10,005.00
<b>Total Dividends Paid:</b>	\$11,708.75
<b>Last Known Price Per Share:</b>	\$44.00
<b>Last Known Total Value:</b>	\$31,900.00
<b>Calculated Return:</b>	<b>335.87%*</b>

# REAL ESTATE

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## REAL ESTATE INVESTOR TAKES ADVANTAGE OF FAVORABLE NEW CONSTRUCTION COSTS

Jim, a real estate professional from North-Central Florida, has been able to utilize his Individual 401(k) account from Midland that allows him to self-direct and invest in what he knows best - real estate. Jim has taken advantage of the favorable new construction costs that have allowed him to achieve returns of over 20%.

### From the Ground Up

A Midland client of seven years, Jim has held his fair share of self-directed assets in his Individual 401(k) plan, including: LLCs, Secured Notes, and Rehab properties. Most recently, Jim has been able to capitalize on the cost benefits of new construction over rehab.

***"Currently, there are more (and better) opportunities with new construction than with rehab."***

- Jim

The first step to any new construction investment is identifying the lot. Once Jim identifies a lot to purchase, he submits an offer in the name of his Individual 401(k). Once the offer is accepted, Midland assists with issuing an earnest money deposit from the 401(k). Midland then works with Jim and the closing agent to make sure that the closing documents properly list Jim's retirement account and to have the final balance paid by the 401(k) at closing.

Once the property is owned by the 401(k), Jim identifies a company to work with on the new construction. Construction agreements entered into, and all associated

costs are paid for by the 401(k). Once construction is complete, Jim lists the property for sale. All sale proceeds are returned to the retirement account tax-sheltered.

### Taking Control With Self-Direction

Self-direction has allowed Jim to take control of his retirement instead of handing his money over to someone else and hoping they do the right thing. Jim is also grateful that self-direction allowed him to avoid the stock market during the recent economic downturn. "If [you] want to be involved and work at it, self-direction is the way to go," says Jim.

### THE INVESTMENTS

1	<b>Lot Purchase Amount:</b> <b>Construction Costs:</b> <b>Insurance/Additional Costs:</b> <b>Total Cost:</b> <b>Sales Proceeds:</b> <b>Length of Investment:</b> <b>Calculated Return:</b>	\$2,777.98 \$55,045.77 \$1,038.00 \$58,298.23 \$70,791.38 7 Months <b>21.4%</b>
2	<b>Lot Purchase Amount:</b> <b>Construction Costs:</b> <b>Property Taxes:</b> <b>Insurance/Additional Costs:</b> <b>Total Cost:</b> <b>Sales Proceeds:</b> <b>Length of Investment:</b> <b>Calculated Return:</b>	\$7,352.46 \$112,370.67 \$83.95 \$998.95 \$120,806.03 \$151,500.98 7 Months <b>34.8%</b>

## REAPING THE BENEFITS OF REAL ESTATE INVESTING WITHOUT THE HASSLE

Jeff, from South Florida, used his self-directed IRA to purchase interest in a Participation Agreement through a builder, allowing him to add a passive real estate investment to his portfolio.

### An Opportunity in Passive Real Estate Investing

Self-directed retirement accounts offer a plethora of alternative ways to invest your retirement assets, including private lending. While more commonly seen as Secured or Unsecured loans directly between the IRA and borrower, another way to lend money from a retirement account is through a Participation Agreement. When Jeff was presented the opportunity to use his self-directed IRA to purchase interest in a Participation Agreement, it was an easy decision to make. "The principals were highly recommended and have a great history of success."

By investing through a Participation Agreement, Jeff was able to use his IRA to purchase an undivided 12.5% ownership interest in a larger existing loan that the builder had in place with the property owner. This loan was already secured by a mortgage on a 2,550 sq. ft. residence, as well as a lender's title policy.

Using an IRA to purchase an interest in an existing mortgage note is also one way to passively invest in real estate without worrying about maintaining the property or dealing with tenants. In Jeff's case, the lender also acted as the loan servicer, as outlined in the agreement's terms.

### Self-Direction: The Key to a Balanced Portfolio

When asked how self-directing his retirement funds has allowed Jeff to reach his retirement goals, it's all about diversification. "The ability to diversify my retirement holdings with alternative/ non-publicly traded assets helps create the overall portfolio balance I sought for my holdings." This ability to further diversify outside of the market is also why Jeff would recommend self-direction to others.

For all of his self-directed needs, Jeff has turned to the Midland team. "The Midland team has provided prompt and pro-active service as needed."

### THE INVESTMENT

<b>Investment Amount:</b>	\$42,000
<b>Total Costs:</b>	\$515
<b>Total Income Received:</b>	\$43,813
<b>Length of Investment:</b>	7 Months
<b>Calculated Return:</b>	<b>9%*</b>

\*This figure was calculated by the IRA owner.

## OWNING REAL ESTATE IN A SELF-DIRECTED IRA IS EASY

Tom P. is a long-term real estate investor. In 2008, he purchased a rental home with his Midland self-directed Roth IRA. He still owns this home in his IRA, and it has substantially appreciated. Learn Tom's story below.

### Purchasing Real Estate in a Self-Directed IRA

Real estate is the most popular asset purchased in a self-directed IRA. A vast number of investors use their IRAs to purchase different real estate assets, including lending money on secured notes.

The most common real estate purchased is a single-family home. Similar assets include Condominiums, Lots, Farm Land, and Vacation Rentals. Please note that there can be no personal use of an IRA-owned property. Personal use is considered a prohibited transaction. Also, the IRA owner cannot compensate him or herself for the management of the asset.

Tom purchased the rental house in 2008. It was a single-family house in Jacksonville, Florida. The home was relatively new when Tom purchased it for \$120,000. His monthly rental income started at \$1,200 per month and is currently at \$1,650 per month. The home's annual costs are approximately \$2,000 for insurance and \$1,500 for real estate taxes. The tenants pay all utilities/yard maintenance. As with any investment, there have been some maintenance costs. However, because the house was newer at the time of purchase, there have not been many significant repairs.

When purchasing a hard asset in an IRA, it must be titled in the name of the custodian. Tom's home is titled Midland Trust Company FBO Tom P. IRA Account #. All rent must be paid to the IRA and all expenses paid from the IRA. Midland has an easy online system to handle these deposits and expenses.

The main benefit of owning assets in your IRA is the tax-free nature of the assets' income or gain. Should Tom assume to sell this property, all proceeds will return to his Roth IRA tax-free. Midland made purchasing real estate in an IRA easy. Tom had also purchased investment real estate in the past and understood the nuances.

The second main benefit of Tom's scenario is that he had chosen to use a Roth IRA. Taxes are paid upfront in Roth accounts, so, when the house sells, and Tom decides to start taking distributions from his Roth IRA, they will be tax-free.

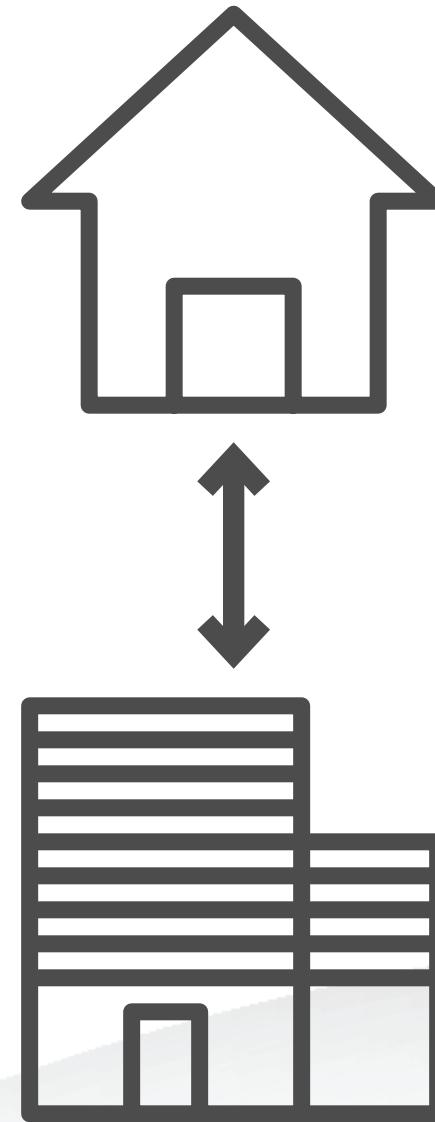
### THE INVESTMENT

<b>Investment Amount:</b>	\$120,000
<b>Total Costs:</b>	\$3,540
<b>Total Income Received:</b>	\$113,760
<b>Length of Investment:</b>	12 Years
<b>Annual Income Return:</b>	<b>10.375%*</b>

\*This figure was calculated by the IRA owner.

# 1031 EXCHANGES

*Midland 1031's role as Qualified Intermediary is limited to acting as qualified intermediary within the meaning of Regulations section 1.1031(k)-1(g)(4) for Federal and state income tax purposes. In this regard, Midland 1031 is not providing other legal, investment, or due diligence services. The taxpayer/Exchanger must direct all investment transactions and choose the investment(s) for the exchange. Nothing contained herein shall be construed as investment, legal, tax or financial advice or as a guarantee, endorsement, or certification of any investments, legal effect or tax consequences of the transfer, conveyance and exchange of the Relinquished Property and/or the Replacement Property.*



## **1031 REVERSE EXCHANGE ALLOWS TAXPAYER TO SECURE REPLACEMENT PROPERTY BEFORE SELLING EXISTING PROPERTY**

Rob from Illinois received an offer on his rental unit on Fort Myers Beach. After consulting with his tax advisor, he looked at a significant amount of gain with this sale. He was advised to consider a 1031 exchange since he intended to purchase another rental property in a more desirable location.

Rob set up a 1031 exchange for his sale and secured a contract on a replacement property, scheduled to close a week after his sale. A week before closing, the buyer's financing fell through, and the sale was canceled. Rob was confident he would find another buyer, but not before closing on his new purchase. The seller of the new property would not extend the closing. If he did not close on the new purchase as scheduled, Rob would lose his deposit and the property. He wanted to know what his options were. Luckily, all was not lost thanks to a Reverse Exchange.

### **How It Works**

IRC Revenue Procedure 2000-37 allowed Rob to acquire the replacement property by using an Exchange Accommodation Titleholder (EAT) before closing on the sale of the relinquished property. This transaction is commonly known as a Reverse Exchange. In other words, it allowed Rob to buy first, then sell, and still have the benefit of a 1031 exchange.

With this strategy, Rob had to be mindful of the deadlines involved. He had to close on the sale of his relinquished property within 180 days of purchasing the replacement

property. He also had to formally identify his relinquished property within 45 days of closing on the new purchase.

Additionally, because there weren't any sales proceeds to apply towards the new purchase, Rob had to come up with the funds to close on the new purchase. Since he did not have that amount of cash-on-hand, he secured a bridge loan with a local community bank to be repaid once his sale closed.

Finally, because he was doing things in reverse order, Rob could not take possession of the replacement property. If he took title to the new property while in possession of his relinquished property, there would be no exchange. For this reason, he needed an EAT to take title to the new property while he secured a buyer for his relinquished property. Luckily, Rob was already working with a Qualified Intermediary to facilitate the Reverse Exchange and establish an EAT for the replacement property.

Rob eventually found another buyer for his property and closed on the sale within the 180-day time frame allotted. At that time, the replacement property was assigned over to Rob, and his exchange was completed.

### **Reverse Exchanges Through the Pandemic**

Given the current market conditions, it is no surprise that there has been an increase in the volume of Reverse Exchanges being completed. Taxpayers don't have the luxury of waiting to purchase until they have closed on the sale of their existing property. The Reverse Exchange has been a valuable tool for real estate investors who want to take advantage of the benefits of a tax-deferred exchange but need to act quickly to keep up with the market demand.

## **1031 EXCHANGING INTO MULTIPLE INVESTMENT PROPERTIES IN A NEW MARKET**

Susan had a high-end vacation rental in Cape Cod that she inherited twenty years ago. She wanted to sell the property and reinvest into multiple rental properties in Florida to provide a more steady stream of income.

Susan went under contract to sell her property for \$1,200,000. She consulted with her CPA and was informed that she would owe approximately \$105,000 in capital gains taxes if she did not do a 1031 exchange.

### **How It Works**

Susan's CPA also advised her that he could not set up the exchange for her and that she would need to engage a Qualified Intermediary (QI) before closing on her sale. She was referred to a local QI and was able to set up her exchange.

The QI advised that she needed to complete her exchange within 180 days of closing on her sale and identify replacement properties within 45 days of closing on the sale.

After she closed on her sale, she found four single-family homes to rent in Florida with a combined value of \$2,400,000. She identified these to the QI before the 45th day.

Susan knew that she needed to apply all of her proceeds towards the purchases and only finance what was required. She found a private lender willing to lend enough funds to

cover all of the purchases and utilize all of her cash from her vacation rental sale.

She closed on all four of the properties before the 180th day.

### **The Result**

Susan was able to purchase four properties in a new market. Because these were single-family homes, she also received a more steady income stream compared to the vacation rental she once had. In addition, she did not have to pay the capital gains taxes on the Cape Cod rental sale since she completed a 1031 exchange.

### **THE 1031 EXCHANGE\***

**Relinquished Property Value:**  
**\$1,200,000** (Basis \$500,000)

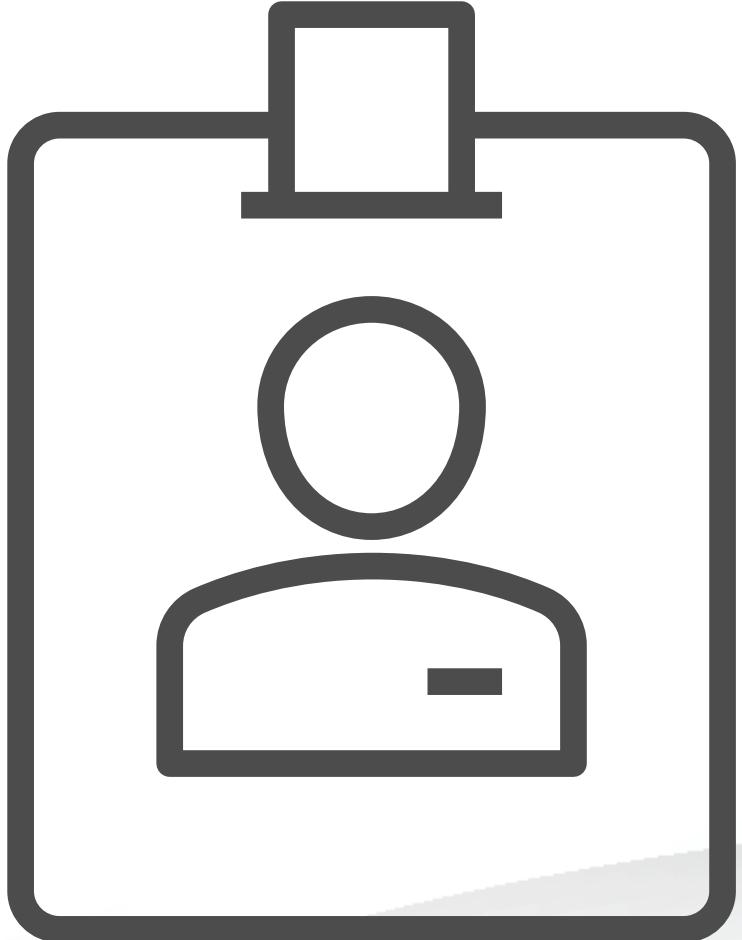
**Replacement Properties Total Value:**  
**\$2,400,000**

<b>Cash Reinvested:</b>	\$1,200,000
<b>Amount of Loan:</b>	\$1,200,000
<b>Total Exchange Fees:</b>	\$2,000
<b>Capital Gains Tax Savings:</b>	\$105,000

\*Numbers have been rounded and closing costs are not included.

# ACCOUNT MANAGEMENT

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## TAKING AN IN-KIND DISTRIBUTION FROM A SELF-DIRECTED IRA

While it is not common, there can be a time where you have an alternative asset in your self-directed IRA, and you need to take a distribution or RMD (required minimum distribution). Below are three unique scenarios that can occur and how to proceed with the distribution. Distributing hard assets can take some planning.

*Please note that it is always best to take cash from your Midland IRA or another IRA before distributing a hard asset. Most investors have multiple IRAs, and the RMD or distribution will be taken from the IRA that owns stocks. Distributing a hard asset can cost money and does take time. Also, distributions from an IRA are taxable unless they are coming from a Roth IRA.*

### Private Stock Case Study

Bob is a 73-year-old investor with an IRA portfolio containing Community Bank Stock. Bob has \$1,000 of cash in his IRA from bank dividends.

At the end of the year, Bob has an RMD of \$10,000. The value of the bank shares is \$30 per share.

To fulfill his RMD requirements, Bob needs to distribute \$1,000 in cash and \$9,000 in bank stock at **fair market value**. Bob would submit a normal distribution for the cash. To get the bank stock distributed, he would need to work with Midland and the bank to get 300 shares of stock retitled in his individual name. The cash distribution and shares would be reported to him on a 1099-R form at year-end. (Usually, an LLC interest can be separated like a stock sale and eligible for an in-kind distribution at FMV.)

### Private Placement Case Study

Typically when purchasing a private placement in an IRA, the investor is purchasing an entire interest that cannot be divided unless the whole investment is sold. It is essential to ask the plan sponsor to know in advance if the asset can be bifurcated.

For example, Jamie owns \$50,000 of ABC Investments, and her current year RMD is \$15,000. If this was the only type of investment she held, and she had no additional cash, she could be required to sell the entire asset to satisfy her RMD.

### Real Estate Case Study

Alice, a 75-year-old woman, owns a rental property valued at \$300,000 in her IRA. She needs to take an RMD from her IRA. A distribution can be accomplished by deeding a percentage of the real estate value to an ownership structure referred to as tenants in common. In our example, Alice's RMD is \$20,000 for this year. She has \$5,000 in cash in her Midland IRA from net rental income. Alice can distribute the cash, but she will need a new deed to distribute the real estate. The in-kind distribution is 5% of the property's current value. Alice would need a certified appraisal, and she would need to have a new deed prepared that shows the property is now owned 95% by her IRA and 5% by her individually as tenants-in-common. The trick now is that all income and expenses must be divided pro-rata based on the new ownership percentages. Since Alice has a property manager, this is not an issue, and at the end of the year, profits will be divided according to ownership percentages. Her 1099-R would show the \$20,000 distribution with a breakdown of \$5,000 as cash and \$15,000 as in-kind.

## TAKING AN IN-KIND DISTRIBUTION FROM A SELF-DIRECTED IRA

While it is not common, there can be a time where you have an alternative asset in your self-directed IRA, and you need to take a distribution or RMD (required minimum distribution). Below are three unique scenarios that can occur and how to proceed with the distribution. Distributing hard assets can take some planning.

*Please note that it is always best to take cash from your Midland IRA or another IRA before distributing a hard asset. Most investors have multiple IRAs, and the RMD or distribution will be taken from the IRA that owns stocks. Distributing a hard asset can cost money and does take time. Also, distributions from an IRA are taxable unless they are coming from a Roth IRA.*

### Private Stock Case Study

Bob is a 73-year-old investor with an IRA portfolio containing Community Bank Stock. Bob has \$1,000 of cash in his IRA from bank dividends.

At the end of the year, Bob has an RMD of \$10,000. The value of the bank shares is \$30 per share.

To fulfill his RMD requirements, Bob needs to distribute \$1,000 in cash and \$9,000 in bank stock at **fair market value**. Bob would submit a normal distribution for the cash. To get the bank stock distributed, he would need to work with Midland and the bank to get 300 shares of stock retitled in his individual name. The cash distribution and shares would be reported to him on a 1099-R form at year-end. (Usually, an LLC interest can be separated like a stock sale and eligible for an in-kind distribution at FMV.)

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# HOW NON-PASSIVE INCOME AND NONREOURSE DEBT CAN AFFECT UBIT IN AN IRA ACCOUNT

## About UBIT

UBIT is a tax due to a retirement plan when it receives business income (as opposed to investment income). As a general rule, UBIT only applies to IRAs that have business income or nonrecourse debt financing.

UBIT applies when an IRA invests and buys ownership in an operating LP or LLC structured as a pass-through entity for taxes and does not pay corporate taxes. LP or LLC operating income flows to its owners as ordinary income. LP or LLC net taxable income flows to the IRA on Form K-1, causing UBIT tax to the IRA as this is business income and does not fit into one of the investment income exemptions. While this is rare, it can happen.

In this type of scenario, the net income that passed through to the investor would be taxed on Form 990-T using the current trust tax rates. There is an exclusion on the first \$1,000 of income. For example, if the K-1 showed \$5,000 of income, \$4,000 would be taxable after the exclusion. (If the company shows a net loss, it is still advisable to file the 990-T and preserve the loss carryforward.)

UBIT is reported and paid by the IRA on Form 990-T. This form is due with tax returns on **April 15th** of each year. The IRA would pay the tax due. The custodian signs and directs payment to the IRS for any tax due as part of the 990-T Return.

Please note that UBIT is different from UDFI (Unrelated Debt-Financed Income). UDFI is capital gains on the profits

from the *sale* of an LP or LLC. UDFI will only apply if there is non-passive income or nonrecourse financing on the investment. UDFI is taxed at the applicable capital gains rate.

## Case Study - Limited Partnership UBIT

Mary invested in a Limited Partnership (LP) with her Traditional IRA. In the first year of the investment, the business reported \$10,000 of Unrelated Business Income.

Mary invested \$100,000 into the LP, which was 5%. Reported on Mary's K-1 from the LP was a nonrecourse debt of \$500,000. UBIT calculates as follows: Mary's percentage of the debt is \$25,000. \$25,000 of debt divided by her investment of \$100,000 is 25%, meaning 25% of the income she received is subject to UBIT. \$10,000 of income from above times 25% is \$2,500.

When calculating UBIT, the investor or entity does not have to pay tax on the first \$1,000. In our simple example, \$1,500 would be subject to UBIT at the trust tax rates. The current rate for this example is 10%, so the tax would be \$150. As you can see, the tax is minimal in the total investment. Again, the tax would be paid on Form 990-T.

*This example is for illustration purposes only. Please consult your tax advisor. Midland Trust Company or its affiliates are not fiduciaries.*



# ABOUT MIDLAND

## ABOUT MIDLAND

Midland specializes in administering Self-Directed IRAs that help clients purchase alternative assets. Get started today. **Please feel free to call Midland at (239) 333-1032, or visit our website to open an account today.**

## AVAILABLE SELF-DIRECTED IRA ASSETS

- Real Estate
- Single-Member LLCs
- Private Lending (Secured & Unsecured Notes)
- Private Placements (Private Equity/Stock)
- Closely-Held LLCs
- Hedge Funds
- Futures
- Forex
- Equities (Stocks, Bonds, & Mutual Funds)
- Precious Metals (Gold & Silver)

## MIDLAND IS NOT A FIDUCIARY

*Midland IRA's role as the administrator of self-directed retirement accounts is non-discretionary and/or administrative in nature. The account holder or his/her authorized representative must direct all investment transactions and choose the account's investment(s). Midland IRA has no responsibility or involvement in selecting or evaluating any investment. Nothing contained herein shall be construed as investment, legal, tax, or financial advice or as a guarantee, endorsement, or certification of any investments.*

*Midland 1031's role as Qualified Intermediary is limited to acting as qualified intermediary within the meaning of Regulations section 1.1031(k)-1(g)(4) for Federal and state income tax purposes. In this regard, Midland 1031 is not providing other legal, investment, or due diligence services. The taxpayer/Exchanger must direct all investment transactions and choose the investment(s) for the exchange. Nothing contained herein shall be construed as investment, legal, tax or financial advice or as a guarantee, endorsement, or certification of any investments, legal effect or tax consequences of the transfer, conveyance and exchange of the Relinquished Property and/or the Replacement Property.*